IN THE

Supreme Court of the United States

OCTOBER TERM, 1978.

No. 77-1413

JANE ARONSON (FORMERLY KNOWN AS JANE LEOPOLDI),
Petitioner,

vs.

QUICK POINT PENCIL COMPANY,
A MISSOURI CORPORATION,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

Nowhere in its brief does Quick Point deal with the real issue in this case: does the enforcement of this contract so conflict with federal policy as to justify federal interference with state law? *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U. S. 470, 479-80 (1974), held that state law should be interfered with *only* if its enforcement would clash with the purposes and objectives of the constitutional policy reflected in the federal patent law. Those objectives are to encourage invention and the disclosure of inventions to the public. While paying lip service to the statements in *Kewanee*, Quick Point never explains how enforcement of this contract will either discourage invention or discourage public disclosure of inventions. On the contrary, enforcement of agreements of this type will further the objectives

of federal law by *encouraging* invention and public disclosure of inventions.

Instead of dealing with this issue, Quick Point makes factual assertions which are foreclosed by the record and plainly incorrect, and endeavors to weave a legal argument by taking a sentence from one case and a phrase from another, ignoring both the logic and the substantive circumstances under which the statements were made. In doing so, it arrives at legal conclusions which are not only internally inconsistent but directly contrary to the principles enunciated in *Kewanee*. Since the whole of Quick Point's argument is premised upon certain erroneous conclusions, we will deal with those matters first and then reply to the equally fallacious legal and policy arguments made by Quick Point.

ARGUMENT

I.

THE FACTUAL CONCLUSIONS OF QUICK POINT ARE ERRONEOUS.

A. Quick Point's Assertion That Petitioner Is Not and Never Was the Owner of a Trade Secret Is Erroneous and Immaterial.

Quick Point asserts that Aronson "is not—and never has been—a trade secret owner" (Q. P. Br. 18), and therefore the contract was only a patent application license which became unenforceable when Aronson abandoned the application. The premise of this argument is that Aronson's keyholder could not be a trade secret because it was not used in the owner's business and did not lend the owner a competitive advantage (Q. P. Br. 15-17). For this statement Quick Point relies upon the definition of a trade secret contained in the Restatement of Torts § 757.

The absurdity of this argument can best be illustrated by showing the result it would produce in other situations. For example, under Quick Point's argument, a brilliant researcher, whether in a university lab or in his basement, who devised the secret formula for an improved gasoline and licensed it to a major oil company could not enforce the license (even if the formula remained secret) because the researcher never "used" the formula in his business. Obviously, the definition in the Restatement of Torts was intended to describe the ordinary situation in which a business has one of its trade secrets misappropriated and is suing for that tort. 1 Milgrim, TRADE SECRETS § 2.02[1] (1978). Either the definition is not intended to apply in licensing situations such as this, or it must be held that

Aronson "used" the trade secret in her business of making and licensing inventions. See *Sinclair* v. *Aquarius Electronics, Inc.*, 42 Cal. App. 3d 216, 116 Cal. Rptr. 654, 658 (1974). Otherwise, if Quick Point is correct, the whole field of licensing trade secrets by those whose business is inventing would be in jeopardy, a result which would surely be contrary to the purposes of the patent law. As noted in *Kewanee:*

> "Trade secret law promotes the sharing of knowledge, and the efficient operation of industry; it permits the individual inventor to reap the rewards of his labor by *contracting* with a company large enough to develop and exploit it." 416 U. S. at 493 (emphasis added).

There can be no doubt Aronson was the owner of a trade secret at the time the agreement was entered into. The uncontested facts are that the keyholder was a secret prior to the agreement. It had not been disclosed to others except under conditions of confidence and it was disclosed to Quick Point under an obligation of confidence (App. 55). It was also clearly of considerable value.* Quick Point admits that at least part of the "bargained-for consideration" was the "disclosure" of the invention and that Aronson was entitled to substantial royalty payments as compensation for that disclosure (See Q. P. Br. 22-23, 33).

This comports with the use of the term "trade secret" in many cases. For example, in *Painton & Co.* v. *Bourns, Inc.*, 442 F. 2d 216, 222 n.2 (2d Cir. 1971), the court of appeals said:

> "Our use of the term 'trade secret' is in the broad sense of any unpatented idea which may be used for industrial or commercial purposes. . . ."

* Quick Point asserts that the keyholder is "simple". Whether it is "simple" or not is irrelevant. Often what later appears "simple" is in reality a most ingenious invention. See *Diamond Rubber Co.* v. *Consolidated Rubber Tire Co.*, 220 U. S. 428, 434 (1911); *Goodyear Tire & Rubber Co.* v. *Ray-O-Vac Co.*, 321 U. S. 275, 279 (1944). Its value is shown by the fact that Quick Point has been very successful in selling Aronson's keyholder, its sales increasing almost continuously since it was first introduced (App. 19, 57).

See also, *Sinclair* v. *Aquarius Electronics, Inc., supra,* 116 Cal. Rptr. at 658. Certainly the keyholder fits that definition.*

But whether or not the keyholder meets the strict requirements of Restatement of Torts § 757 and is thus entitled to be called "trade secret", or even constitutes a "glob of technology" (Q. P. Br. 18, n.6), such that it can be called "know-how" is irrelevant. It had been clear, at least until the court of appeals' decision here, that a trade secret or know-how owner, or the submitter of an idea, could enter into an enforceable contract with respect to that idea or invention. See, *e.g., Painton, supra,* 442 F. 2d 216; *Richter* v. *Westab, Inc.*, 529 F. 2d 896, 902 (6th Cir. 1976); *Desny* v. *Wilder*, 46 Cal. 2d 715, 299 P. 2d 257, 265-67 (1956); *Donahue* v. *Ziv Television Programs, Inc.*, 245 Cal. App. 2d 593, 54 Cal. Rptr. 130, 134 (1966). See also, 2 Milgrim, TRADE SECRETS § 8.03 (1978) and 3 Nimmer, COPYRIGHT § 16.04 (1978). This was true even in the presence of a rejected patent application. *Gesing* v. *Grand Rapids Hardware Co.*, 362 F. 2d 363 (6th Cir. 1966). The issue here is not whether the subject matter of the agreement is technically a "trade secret" but whether the enforcement of the agreement conflicts with the purposes and objectives of the patent law. Since it does not, it is immaterial whether the keyholder is a

* Quick Point argues that this case is distinguishable from *Warner-Lambert Pharmaceutical Co.* v. *John J. Reynolds, Inc.*, 178 F. Supp. 655 (S. D. N. Y. 1959), *aff'd,* 280 F. 2d 197 (2d Cir. 1960), because in *Warner-Lambert* the formula remained a secret for several years and no patent was applied for by the licensor. Those factual differences do exist between the two cases, but under the principle adopted by the court below and urged here by Quick Point, those facts make no difference. The rationale of the decision below, and Quick Point's argument here, is that once an idea, whatever its form (*i.e.*, a formula, a design or a process), is publicly known and not the subject of a patent, it is contrary to the objectives of the patent law to require a licensee to live up to its agreement to pay royalties on the use of that idea. But that rationale is as applicable to a once-secret formula which remained secret for a while after its first use as it is to a secret design which is disclosed to the public upon its first use. At the time the contract dispute arose in *Warner-Lambert* the licensed formula was as much in the "public domain" as the keyholder in this case.

trade secret or simply an idea, the confidential disclosure of which, Quick Point has admitted, entitled Aronson to substantial compensation (Q. P. Br. 33).

B. The Assertion That the Parties Intended That Royalties Cease if No Patent Issued Conflicts with the Findings of Both Courts Below, the Allegations of Quick Point's Complaint and the Record.

Quick Point asserts that the "cardinal rule for construing a contract is to ascertain and give effect to the intent of the parties" (Q. P. Br. 48). It follows that statement with a highly strained argument which comes down to a contention that the contract should be construed as *not* requiring royalty payments after the abandonment of the patent application because, Quick Point surprisingly argues, that was not the intention of the parties.* This assertion is contrary to the facts and totally lacking in merit.

First, both the district court and the court of appeals found the facts to be exactly contrary to Quick Point's argument. The district court found that "the language of the agreement is plain, clear and unequivocal and has no relation as to whether or not

* The argument is primarily based upon the agreement's providing that Quick Point would have "the exclusive right to make and sell" the keyholder. The fact that the license was exclusive does not necessarily mean that it had to be a patent license. It is not uncommon to have an exclusive trade secret or know-how license. See, e.g., *Painton, supra,* 442 F. 2d at 219; *Aktiebolaget Bofors* v. *United States,* 194 F. 2d 145, 147 (D. C. Cir. 1951); and *Pickren* v. *United States,* 378 F. 2d 595, 597 (5th Cir. 1967). There is also no reason that a single agreement cannot provide for the contingencies of a patent either issuing or not issuing. Thus, the obligation to pay the reduced royalty as long as Quick Point made the keyholder is not inconsistent with the notion that if a patent were to issue, Quick Point would be the exclusive licensee under the patent and the parties would agree upon appropriate action in the event infringers appeared. The effect of the agreement was that Aronson was prohibited from licensing its design to anyone else (App. 39) and if a patent issued, the exclusivity granted by the agreement would also entitle Quick Point to be free from competition by others who did not have a license under Aronson's patent.

a patent is ever granted or is not granted". (App. 63, ¶ 2). The court of appeals echoed this finding by stating that: ". . . *the parties here did not expressly condition their agreement on the issuance of a patent, . . .*" (emphasis supplied, App. 73, n.11).

This Court has long recognized what has come to be known as the "two-court rule". Under this rule, the Court will not "undertake to review concurrent findings of fact by two courts below in the absence of a very obvious and exceptional showing of error". *Graver Tank & Mfg. Co.* v. *Linde Air Products Co.*, 336 U. S. 271, 275 (1949). See also, *United States* v. *Ceccolini,* 435 U. S. 268, 273 (1978), and *Berenyi* v. *Immigration Director,* 385 U. S. 630, 635-36 (1967). Therefore, the fact that the contract was not dependent on the issuance of a patent is correct and controlling here.

In addition, Quick Point's complaint admits—indeed asserts—that the contract obligates Quick Point to continue paying royalties even though no patent issued (App. 5, 6). Nowhere is it alleged that the parties intended the royalties to cease if Aronson failed to obtain a patent. Instead, the entire premise of the complaint is that the contract requires continuing royalties but that such a contract is unenforceable or illegal (See, *e.g.*, App. 5-6, ¶¶ 9, 14). Similarly, the stipulation of facts expressly states that the contract obligated Quick Point to pay the 2½% royalty so long as it continued to sell the keyholder (App. 18). Having both stipulated and affirmatively asserted a contrary position, Quick Point can hardly be heard to raise the contention that it and both courts below have all misinterpreted the contract.

Even if the two-court rule were not applicable and Quick Point had not waived the issue by admitting and premising its complaint on the opposite interpretation of the contract, the contract language and the parties' actions decidedly show that Quick Point's belated contention is totally without merit.

The contract specifically and unequivocally provides that the royalty will continue at 2½% for as long as Quick Point con-

tinues to sell the keyholder (App. 25). There is nothing in the contract which says this obligation will cease when and if it is determined that no patent will issue.

The fact that Quick Point did not stop paying royalties when it became clear no patent would issue is compelling evidence against its present assertion. Obviously, if the parties had not intended for the royalties to continue, Quick Point would not have continued paying them. See *Warner-Lambert, supra,* 178 F. Supp. at 668.

Quick Point's counsel, in a letter dated April 10, 1961, specifically stated that even if no patent were granted Quick Point is obligated to pay the royalties on any keyholder manufactured in accordance with the disclosure of the application. Quick Point now attempts to avoid this clear admission by saying that the attorney was not an officer and thus his statement was not binding on it. But the letter itself states that its purpose is "to confirm Mr. Goessling's warning. . . ." (App. 39) and shows that a copy was sent to Quick Point (App. 40). At no time has Quick Point ever denied the position taken in this letter and the stipulation of uncontested facts states that it was sent to Aronson "on behalf of [Quick Point] . . . ." (App. 19). Under these circumstances, the letter as a matter of law constitutes an admission by Quick Point that the contract obligated it to pay royalties even if no patent were issued. FED. R. EVID. 801; *Gerhart* v. *Henry Disston & Sons, Inc.,* 290 F. 2d 778, 789 (3d Cir. 1961); *Noel* v. *Roberts,* 449 S. W. 2d 572 (Mo. 1970); McCormick, EVIDENCE § 267 at 643-44 (2d ed. 1972).

A letter written by the president of Quick Point, and totally ignored by Quick Point's brief, removes any possible doubt on this point. In that letter, written years after it was known no patent would issue, Mr. Goessling said "Please be advised that we will continue our payments to you as per our original agreement. . . ." (App. 41). If it had been the intention of the parties that payments cease if no patent issued, it is inconceivable that Mr. Goessling would have made that statement.

Finally, Quick Point ignores the circumstances surrounding the drafting and execution of the contract. The addendum reducing the royalty rate from 5% to 2½% was not in the agreement drafted by Mr. Goessling but was added by Aronson after a telephone call from her agent to Goessling (Q. P. Br. 6, 50-51; App. 23-25). If the parties had intended that the issuance of a patent was a condition to Quick Point's obligation to continue the royalties and that the agreement would terminate if no patent issued, it would have been in Aronson's interests not to propose the addendum but instead simply to sign the agreement as proposed by Goessling calling for a 5% royalty. In that way, Aronson would have received 5% royalties until it was definitely decided no patent would issue, even if that took longer than five years. Obviously, Aronson agreed to accept a lower royalty rate in return for something else not in Goessling's draft; that something else being the obligation of Quick Point, in the event no patent issued, to pay royalties as long as Quick Point manufactured the keyholder.

These facts also dispose of Quick Point's "commercial frustration" argument, equally absent from the complaint (Q. P. Br. 48-53). It is clear the commercial frustration doctrine is inapplicable here:

> "Frustration is no defense if it was reasonably foreseeable. The burden of proving that the risk of the frustrating event was not reasonably foreseeable rests with the party seeking to excuse performance of a contractual obligation. It is settled that if parties have contracted with reference to contemplated risks, they may not invoke the doctrine of frustration to escape the obligations." *Gold* v. *Salem Lutheran Home Ass'n,* 53 Cal. 2d 289, 347 P. 2d 687, 689 (1959).

See also, *Lloyd* v. *Murphy,* 25 Cal. 2d 48, 153 P. 2d 47 (1944). This principle, *i.e.,* that commercial frustration will not apply if the intervening event was reasonably foreseeable, is embodied in the doctrine of comercial frustration in this country. See 18 Williston, CONTRACTS § 1954, at 135-36 (3d ed. 1978); 6 Cor-

bin, CONTRACTS § 1354 (1962). More importantly, it is the law in Missouri, *Howard* v. *Nicholson*, 556 S. W. 2d 477, 482 (Mo. App. 1977) ("If the event was reasonably foreseeable then the parties should have provided for its occurrence in the contract and its absence indicates an assumption of risk by the promisor.").

There can be no doubt that when two parties enter into a licensing agreement for an invention on which a patent application has been filed, it is at least reasonably foreseeable that the Patent Office may not grant the patent.* It was incumbent on Quick Point to make continuance of the royalty payments contingent on the issuance of a patent if that is what was intended. Its failure to do so, and the other circumstances, show that the parties contemplated the possibility that no patent would issue, but in that event, wanted the agreement to continue at the lower royalty rate. Quick Point's subsequent conduct under the agreement merely reaffirms this fact.

C. The Obligation to Pay Royalties Is Not Perpetual.

Quick Point persistently and erroneously refers to its obligation to pay Aronson royalties as being "perpetual" or "indefinite" (*e.g.*, Q. P. Br. 2, 5, 27-28, 34-35, 48, 53). The contract is not in any sense perpetual. Such an argument was rejected in *Warner-Lambert, supra*, 178 F. Supp. at 660-62, where, as here, the obligation to pay royalties was co-extensive with the licensee's decision to manufacture the product and thus dependent on acts exclusively within the licensee's control. Quick Point can terminate the obligation by deciding to manufacture no more of these keyholders. In no way can such a contractual obligation be termed perpetual or indefinite. See 1 Williston, CONTRACTS § 38 (3d ed. 1957) and 3 Corbin, CONTRACTS § 553 (1960).

* Between 1951 and 1955, 351,649 patent applications were filed on inventions (as opposed to designs or plants). During that same period 192,651 patents were actually issued. 1960 STATISTICAL ABSTRACT OF THE UNITED STATES 543.

II.

ENFORCEMENT OF THE CONTRACT IS CONSONANT WITH FEDERAL PATENT AND COMPETITION POLICY AND SERVES IMPORTANT STATE INTERESTS AS WELL.

Having constructed the straw man that this contract is solely the license of a patent application, Quick Point proceeds to flail away at it using bits and pieces of various patent and antitrust decisions of this Court for a club. Quick Point's argument, however, is nothing more than sophistry because it is based on an inaccurate premise and, like the court below, it applies words of this Court without analysis of the decisions and policy behind those words.

A. Quick Point's Assertion That Enforcing the Contract Will Cause Diversion from the Federal Patent System Misses the Point and Is Factually Tenuous.

Quick Point argues that enforcing this contract will create substantial incentives to avoid recourse to the federal patent system because inventors "who believe their inventions to be patentable will have every incentive to license their inventions during the period their patent applications are pending, and then abandon their applications after they have obtained from their licensees favorable licensing agreements providing for royalty payments for periods of time in excess of those which are available to *bona fide* patentees." (Q. P. Br. 28).

The test under *Kewanee* is not whether enforcement of this contract will cause *any* diversion from the federal patent system; it is whether or not enforcement will create "a substantial risk that holders of patentable inventions would not seek patents, but rather would rely on the state protection. . . ." *Kewanee*, 416 U. S. at 489. *Kewanee* recognized that some diversion from the patent system might occur by enforcing state trade secret law but the Court nevertheless refused to find the state law was pre-

empted. Thus, even assuming inventors with contracts like this one would have an incentive to abandon their patent applications—an assumption which we will show is erroneous—it does not follow under *Kewanee* that enforcement of the contract conflicts with federal patent law.

Assuming, as Quick Point argues, that the question is diversion from obtaining a patent, it is clear there is less likelihood of diversion in this case than in *Kewanee*. In *Kewanee* the Court specifically approved protection for inventions which could have been patented but which are instead kept secret. Enforcing a license agreement where the invention can be kept secret is much more likely to discourage patent applications than enforcing an agreement where first sale of the article by the licensee discloses it to the public.

Indeed, the truly anomalous thing about the decision below and Quick Point's position here is that if the licensed invention were one which did not become public upon sale of the article by the licensee, the inventor could continue to collect royalties even if he abandoned the patent application. Both Quick Point and the court of appeals would enforce an agreement calling for royalties on a patentable invention *if* the invention remains secret, even though the licensor may collect royalties for a much longer period of time than if a patent had been obtained. On the other hand, *if*, as here, the sale of the licensed article renders the invention no longer secret, the court below and Quick Point say the license is not enforceable. Yet in the latter case, the inventor is much less likely to abandon the patent application than he would be in the former where he at least may keep his invention secret.

Quick Point's argument that enforcement of this contract would create incentives to avoid recourse to the patent system also misses the real point made in *Kewanee*. The objective of the patent laws is to promote invention. It does so in two ways: first, encouraging inventors by holding out to them the opportunity to exclude others for 17 years if the invention is patentable, and second, by compelling the public disclosure of the invention in return for granting the patent, thus making it known to the public, which should encourage further invention. Quick Point makes the fallacious argument that any state law which discourages inventors to any degree from obtaining patents must therefore conflict with federal patent policy. But that argument elevates the *means* over the purpose or objective of the patent law. For example, a state law financing research on the condition that any resulting invention be disclosed and dedicated to the public, instead of patented, would not be inconsistent with the purposes of the patent law. Obtaining letters patent is not the important thing. The objective is to foster inventions and their disclosure to the public.* Both the patent law and state law may accomplish these goals without conflicting, and enforcing this agreement cannot under any conceivable circumstances have the effect of undermining or being contrary to those objectives.

In addition, Quick Point's argument that enforcing the agreement may cause inventors to abandon patent applications is tenuous at best. First, it invites this Court to make a rule of law based on the assumption that inventors will act in bad faith. Second, it erroneously assumes any inventor is better off with a contract potentially lasting longer than 17 years with a licensee having competitors free to make the identical device, than he would be with a patent license limited to 17 years but with a licensee who has a monopoly on the manufacture of the device. Thus, Quick Point blithely assumes Aronson would have preferred in 1961 to have royalties from Quick Point so long as it made the device rather than a patent and royalties based on

* The headings on pages 26 and 27 of Quick Point's brief say that enforcing this agreement would conflict with "the objectives of the patent laws", and that enforcement would undermine the "preeminent patent law objective of encouraging the disclosure of new inventions". Although these references to the "objectives" of the patent law are contained in the headings, the argument which follows them is merely that enforcement of the agreement would create an incentive to patent applicants to abandon their applications. It never ever deals with the fact that enforcing agreements of this type *does* have the result of disclosing the invention to the public.

Quick Point's exclusive market position for 17 years. Aronson faithfully prosecuted her application, even taking an appeal to the Board of Appeals (App. 20). Given the fact that many inventions have a commercial life of much less than 17 years, it is unreasonable to assume inventors would prefer a potentially longer license agreement for royalties on sales of only one of a number of producers as opposed to a 17-year license for royalties from the producer who has a monopoly.

Even if there were any real danger an inventor would abandon an application on a patentable invention, the licensee can easily protect himself. First, he can require in the contract that the inventor diligently prosecute the patent application, thereby making the intentional abandonment of it for the purpose of taking unfair advantage of the licensee a breach of the contract. The license could also provide, as is quite common, that the licensee will prosecute the patent application. Finally, the licensee can insist upon a provision making the obligation to pay royalties cease if no patent issues. Thus, Quick Point's argument not only misses the point but is factually unsound.

B. Quick Point's Other Arguments That Enforcement of This Contract Conflicts with the Federal Patent Policy Are Equally Without Merit.

Quick Point urges that Aronson is in a better position than the holder of a patent and enforcing the contract thus conflicts with federal patent policy (Q. P. Br. 30-31). As noted above, this argument erroneously assumes Aronson would not be better off with 17 years of royalties from its licensee and the right to exclude all others from making the invention. But even if Quick Point's assumption were correct, it would not be controlling. The holders of the famous secret formula for Coca-Cola may be said to be in a better position than had the formula been patented but under *Kewanee* that is not the test for federal preemption. The test is not whether the inventor is better off but whether the

objectives of the federal policy encouraging innovation are frustrated and the public thereby harmed.

Quick Point relies on *Sears, Roebuck & Co.* v. *Stiffel Co.*, 376 U. S. 225 (1964), and *Brulotte* v. *Thys Co.*, 379 U. S. 29 (1964). But, as previously pointed out, those cases are inapplicable. *Sears* involved a court order under state law excluding the entire public from an invention equally as much as a federal patent but without meeting the invention requirements or the temporal limitations of a federal patent (See Pet. Br. 15-17). *Brulotte* involved the conclusion that royalties on a patented invention after expiration of the patent constituted an unlawful attempt to extend the monopoly granted by the patent, and the Court expressly distinguished contracts on unpatented articles. (See Pet. Br. 18-20). Here there simply is no exclusion of the public which brings into operation any of the patent preemption policies enunciated by this Court.*

In reality, Quick Point is urging this Court to establish a rule forcing all patent applicants to take every possible step, leaving no stone unturned, in attempting to obtain a patent. In *Kewanee* the Court found that such a requirement is simply not federal policy since it may result in the issuance of invalid patents which do pose a threat to the public:**

> "The point is that those who might be encouraged to file for patents by the absence of trade secret law will include inventors possessing the chaff as well as the wheat. Some of the chaff—the nonpatentable discoveries—will be

* Quick Point also abuses the citation of *Painton, supra,* by implying that *Painton* set up a rule differentiating trade secret licenses from licenses involving patent applications (Q. P. Br. 29). Rather than establishing a classification differentiating patent applications from trade secrets, the court in *Painton* followed the prudent course of declining to decide a question not presented. See 442 F. 2d at 225.

** It would similarly not be consistent with federal policy to permit the collection of royalties only during the pendency of the application and not thereafter. Under those circumstances an inventor would be encouraged to keep the application on an unpatentable invention pending as long as possible. It would certainly not be in the interest of the patent system to encourage that practice.

thrown out by the Patent Office, but in the meantime society will have been deprived of use of those discoveries through trade secret-protected licensing. Some of the chaff may not be thrown out. This Court has noted the difference between the standards used by the Patent Office and the courts to determine patentability. . . . In [*Lear*], the Court thought that an invalid patent was so serious a threat to the free use of ideas already in the public domain that the Court permitted licensees of the patent holder to challenge the validity of the patent. Better had the invalid patent never been issued. More of those patents would likely issue if trade secret law were abolished." (416 U. S. at 488-89)

Under the decision below the inventor whose invention cannot be kept secret once it is marketed is faced with a very difficult choice. He may apply for a patent and license his invention immediately (as Aronson did), but he cannot provide for royalties over a period of time because once the invention is marketed it enters the "public domain" and the licensee cannot be forced to pay royalties. Or he can apply for a patent and not immediately license his invention. If no patent issues, his invention is still secret, but the only way he can reap profit from it is to manufacture it himself, or sell it for a lump sum. Faced with these alternatives a would-be inventor is likely to be discouraged rather than encouraged. Moreover, even if he ultimately manufactures the invention himself, its disclosure to the public is very likely to be delayed.

In *Kewanee* this Court indicated that it is not desirable to postpone unnecessarily the commerical use of trade secrets; that it is important to disseminate rather than hoard knowledge; and that one benefit of licensing inventions is the opportunity to use the most efficient manufacturing and marketing structures within an industry. Indeed, the following statement from *Kewanee* is particularly applicable here:

"Another problem that would arise if state trade secret protection were precluded is in the area of licensing others to exploit secret processes. The holder of a trade secret would not likely share his secret with a manufacturer who

cannot be placed under binding legal obligation to pay a license fee or to protect the secret. The result would be to hoard rather than disseminate knowledge. [*Painton*]. Instead, then, of licensing others to use his invention and making the most efficient use of existing manufacturing and marketing structures within the industry, the trade secret holder would tend either to limit his utilization of the invention, thereby depriving the public of the maximum benefit of its use, or engage in the time-consuming and economically wasteful enterprise of constructing duplicative manufacturing and marketing mechanisms for the exploitation of the invention. The detrimental misallocation of resources and economic waste that would thus take place if trade secret protection were abolished with respect to employees or licensees cannot be justified by reference to any policy that the federal patent law seeks to advance." (416 U. S. at 486-87)

The better rule, which Aronson urges this Court to adopt, is that states may enforce contracts providing for continuing royalties in return for the disclosure of inventions, even when a patent application has been filed, where patentability is not a condition of the contract. Ruling for Quick Point in this case would not only usurp the bargain the parties freely entered into, but would also frustrate the policies Congress sought to foster in the federal patent law.

C. Enforcement of the Contract Does Not Frustrate National Competition Policy.

Quick Point argues that enforcement of this agreement will frustrate national competition policy. In so arguing, its brief parrots, like a broken record, the notion that ideas in the public domain are free, citing *Sears, et al.* (Q. P. Br. 36-43, 46). While that statement certainly is the law where one is trying to prohibit the copying of an idea in the public domain, Aronson is not attempting to prohibit the public from copying her idea. As stated before, that phrase does not mean that valid contracts disclosing an idea cannot be enforced (Pet. Br. 25-32). Quick

Point fails to mention or discuss, much less distinguish, the numerous cases so holding (Pet. Br. 28-32).

In the section dealing with national competition policy, Quick Point asserts there is no difference between Aronson and Adkins, the inventor in *Lear, Inc.* v. *Adkins*, 395 U. S. 653 (1969) (Q. P. Br. 38, n.26). In *Lear*, Adkins *did* obtain a patent. This Court found an invalid patent such a threat to the public that not only would it allow the licensee to challenge the patent, but it would also offer the licensee the opportunity to stop paying royalties as an incentive to encourage such challenges. Here, Quick Point did not condition the license on the issuance of a patent and no patent was ever granted. There never has been any threat to the public which would mobilize the policy found in *Lear* because there is no patent to be declared invalid and therefore the parties should be left to their bargain.

This fact also disposes of Quick Point's reliance upon the statement in *Lear* that if the licensee is not permitted to challenge the validity of the licensed patent "the public may continually be required to pay tribute to would-be monopolists without need or justification". 395 U. S. at 670. Quick Point asserts that Aronson seeks such "tribute" here (Q. P. Br. at 43). What Quick Point fails to point out is that the "tribute" in *Lear* was obtained by a *monopolist* from the public—via a patent which might be invalid. The public is not being forced to pay Jane Aronson any tribute because she has no monopoly. There is no patent here.

Quick Point argues that enforcing royalty payments while a patent application is pending may be justified on the grounds that the licensor, by disclosing his invention to a licensee, will have provided an important head start advantage for which the licensee should pay (Q. P. Br. 43). But it argues that to require royalty payments after the application has been abandoned would funnel "excessive" rewards to the licensor at the expense of the licensee (Q. P. Br. 45). First, this argument is contrary to the rationale of the decision below and the basic argument

made by Quick Point itself. If, as the court below held and Quick Point here argues, it is contrary to federal policy to charge a royalty on an invention that is not patented and no longer secret, then a contract to pay royalties while an application is pending and where the subject matter is no longer secret cannot be enforceable. At that point there is no patent and there is no secret; anyone is free to copy the invention.

In addition, Quick Point's argument makes no sense either economically or in terms of the federal policy encouraging invention. Why, for example, is it reasonable to permit the collection of a royalty only during the term the patent application is pending instead of during a longer period agreed upon by the parties? The length of time an application is pending can vary considerably and has no relationship whatsoever to the value of the disclosure of the invention to the licensee. Indeed, the speed with which the application and amendments can be reviewed may depend upon the backlog at the Patent Office at any given time, or even that of a particular examiner. What federal policy is benefited by creating a rule of law that would encourage applicants to stall and keep applications pending after it is clear they should be abandoned?

Moreover, there is no basis for Quick Point's assertion that there would be "excessive" rewards to the licensor if the royalties went on after the patent application is abandoned. Who is to decide what is excessive? Is it not better to leave the matter to the parties' agreement? In this particular case, the parties agreed that the reduced royalty would be paid as long as Quick Point made the device. But in other agreements the parties might agree to other terms. For example, they might agree to royalties for 5 years, or 10 years if no patent issued, or royalties upon the first million or some other number of items manufactured using the idea, or royalties of a certain maximum dollar amount. All of these are possible agreements which the parties most familiar with the economic circumstances could reasonably enter into, and there is no basis in economics or law for the courts to

interfere with that free bargaining process and impose an arbitrary federal rule that the royalties cease once the patent application is abandoned, no matter how long or short it has been pending.

In this section (pp. 43, 46), Quick Point returns to its argument that what was bargained for here was really two separate things—disclosure of the secret and rights under any patent which might issue—and that when the application was abandoned the second half of the bargain failed. Therefore, Quick Point argues, royalties should have stopped when the application was abandoned. As in the other sections of its brief where it makes this argument, Quick Point totally ignores the fact that the royalty rate was also cut in half. The part of the agreement providing a 5% royalty did not require payments at that rate for "as long as you continue to sell" the device. That clause was made applicable only to the reduced royalty.

Quick Point asserts that the "excessive" royalties paid by Quick Point make it increasingly difficult for it to compete in the keyholder market. The fact, of course, is that Quick Point's sales have been steadily increasing (App. 19, 57), and while the payment of the royalties means that Quick Point is sharing its profit with Aronson, as it might with a partner or joint venturer, there is no evidence that its prices are higher than those of a competitor. Moreover, how are we to know that the value of the disclosure to Quick Point does not offset the cost of paying the royalties? Obviously, since it will vary from case to case, this is a matter which should be left to the parties in their bargaining process and not decided by the federal courts.

Quick Point says that enforcing this contract may exert a "cloistering effect" on free markets (Q. P. Br. 42), but nowhere does it explain this cloistering effect. This Court has recognized many times that "[e]very agreement concerning trade . . . restrains." *Chicago Board of Trade* v. *United States*, 246 U. S. 231, 238 (1918). But the Court has never indicated that there is a *per se* rule against contracts.

To require a manufacturer to live up to his agreement to pay royalties does not conflict with the national policy of free competition any more than an agreement to pay a salesman a commission, or any other agreement making the costs of one manufacturer higher than the costs of another. In effect, Quick Point argues that any time an agreement burdens or increases the costs of any single competitor, that agreement is contrary to national competition policy. But that same argument could be made about a labor agreement in which one manufacturer ends up paying his workers a higher wage than another or a contract one manufacturer has with his manufacturer's representative calling for a higher commission than his competitors pay their representatives.

There are many situations in the area of intellectual property where there is neither a patent nor continued secrecy but where a contract calls for the payment of continuing fees or royalties by a manufacturer or a user of an idea. For example, we previously referred to agreements calling for royalties on the use of a format or concept for a television series, or a motion picture, or for the use of an advertising idea (Pet. Br. 33-34). Such agreements are commonplace in our economy. There is no patent involved, and the idea certainly is not secret after its first use. The enforcement of those contracts does not in any way conflict with national competition policy. The same is true here. Requiring Quick Point to live up to its agreement to pay royalties for the use of Aronson's unpatented idea, her keyholder, in no way conflicts with the national policy of free competition.

D. Contrary to Quick Point's Assertion the State Interest at Stake in This Case Is Both Legitimate and Important.

Quick Point argues that preemption of state law is appropriate here because the "countervailing state policies and equitable considerations are so weak" (Q. P. Br. 47). Quick Point attempts to differentiate this case from *Kewanee* which, it says,

involved a body of long-standing state law designed to further legitimate and important state objectives such as the promotion of commercial morality.

Once again Quick Point's argument is incorrect. This Court noted in *Kewanee* that trade secret law was imported into this country from England by means of the landmark case of *Peabody* v. *Norfolk*, 98 Mass. 452 (1868). Certainly the policy of enforcing contracts freely entered into existed prior to 1868. In fact, the enforcement of contracts is one of the foundations of English and American jurisprudence. Missouri, as well as all of the states, certainly believes that there is a strong public policy in favor of enforcing contracts. See, ***Willman*** **v.** ***Beheler***, 499 S. W. 2d 770, 777 (Mo. 1973) ("There is a counterbalancing public policy which recognizes the interest of the public in protecting the freedom of persons to contract and in enforcing contractual rights and obligations."). Even the framers of the United States Constitution thought that contractual obligations hold such a special place in American political philosophy that they provided that the states may not pass any law "impairing the Obligation of Contracts. . . ." U. S. Const. art. I, § 10, cl. 1. As previously pointed out this Court has frequently admonished against striking down private contracts on the grounds of antitrust or other public policy (Pet. Br. 34-35). Quick Point fails even to mention this point, much less respond to it.

The state interest involved here is long-standing, legitimate and important, and there is no reason to interfere with it.

CONCLUSION

In spite of all of the arguments made by Quick Point in its brief, one fact clearly remains. There is simply no reason on the basis of federal patent policy, or federal competition policy, for the federal courts to interfere with the normal operation of state contract law in this case. Aronson is not seeking to avoid federal law, or to make an exception to federal law, because no federal law is violated by this agreement. The sole question here is whether the enforcement of state contract law so conflicts with the purpose of the federal patent law that the Court should preempt the state law. The purpose of the federal patent law is to encourage invention and the disclosure of inventions to the public. Since enforcement of the contract here will not in any way conflict with that purpose but will further it, the federal courts have no reason to interfere with state law enforcing this contract. Both federal and state law can peacefully coexist and fulfill the constitutional mandate to "promote the Progress of Science and useful Arts." Only by allowing both systems to operate to encourage invention and the public disclosure of inventions can this Court insure the continued preeminence and vitality of American technological development.

Respectfully submitted,

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